The future of Islamic Finance

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ABSTRACT

Now I would like to return to the subject of Islamic banking. It is not only about rejecting riba, usury or interest. Islamic banking is also about obeying the Islamic ethnical code in the market. In banking, there should be qard al-hassan - ie, good loans. Not only should it be usury free but there should not be hidden costs or gambling involved.

I am not suggesting that Islamic banking should replace the current banking system. But I would like to suggest there be more resort to Islamic banking systems and principles in order to prevent greed and abuses from taking over. Islamic banking should stay free from gambling and speculation, from the invention of financial products and unlimited freedom to create money and leveraging, which have all contributed to the downfall of the riba-based financial system.

Islamic banking and the wealth of the Muslims will cause the rest of the world to link up with Muslim countries. Muslims will feel comfortable doing business without going against the injunctions of Islam. Provided that the abuses of the riba banks are avoided, there will not be the periodical collapse of the Islamic financial system. We are seeing how the Islamic banks have remained unaffected by the current crisis. Inshaallah, it will remain crisis-free in the future.

FULL TEXT

Bank Negara Malaysia through its Malaysia International Islamic Financial Centre organised an Islamic Finance Seminar in Istanbul from Sept 28-29, 2011. Tun Dr Mahathir Mohamad, former Prime Minister, delivered his Special Keynote Address at the event. Below are excerpts from his speech.

`I WAS GIVEN FOUR SUBJECTS TO speak on this occasion. All are about finance. I have chosen to speak on the future of Islamic finance not because I can see into the future or that I know as much about the subject as the experts in this hall. I have chosen this subject because I believe it is of current interest.

Although Islamic finance is not involved, we are conscious of the financial crisis being faced by the whole world today. It is of such a magnitude that no country and no business can escape from it. It is so complex that the best brains, the financial experts and the Nobel laureates of the world have not been able to come up with a real solution. Five years after it started, it is still rolling on, bringing to their knees, the great and the not-so-great. Indeed, it is the mightiest of all which became the principle cause and victim. When the mightiest fall, others will be dragged down with it.

It would seem that the very financial institutions created to support the economies of the rich, to finance industries and trade, have now turned upon their creators to impoverish and destroy them. Why and how did this happen? Why am I talking about this crisis when talking about Islamic finance? It is because we can learn about the mistakes of conventional finance if Islamic finance is to avoid the same fate.

The Western banking system has served the developed countries very well. With the money created by the riba banks, the countries of Europe and North America grew rich. They manufactured goods and provided services to themselves and the world, ie, they enriched themselves through doing real business.

Not satisfied with merely purchasing raw materials for their products, they conquered their trading partners so as to ensure supply. This way, they could become even richer, importing cheap raw material from their colonies to be processed into high-value-added products for their home markets and for their closed colonial markets. There was

no talk about open, free markets then.
The riba banks financed the building of great ships to carry their products and the raw materials. Powerful naval forces protected their trade routes. More and more money was created as the demand for the financing of industries and trade grew. Their banks created the money.
This could have gone on forever but after the second World War, the great European countries had to give up their colonies.
Their answer to this debacle was to build a European economic fortress. The European Union had the potential to become the richest and most powerful economic bloc, and together with America, the old colonial empires could be revived in another form.
But in the post-war years, new industrial powers emerged in the East. The products of these newly industrialised countries started to compete against those of Europe and America. To cut a long story short, despite their combined economic capacity, Europe and America lost in the contest for market share. Their products were almost totally pushed off the shelves in the world market.
Their defeat in the manufacturing, construction, trade and service industries led to their switch to the financial markets. Beginning with investments in the share markets of the world, they invented new financial products. As with the shares in the stock markets, these products bear no relation to the real business done by the companies and corporations concerned. It is not the dividends which attracted their investments in stocks and shares. It is the possibilities for capital gains. Repeated and sustained purchases of shares would push up the share prices. Once appreciated, the shares would be dumped by them and capital gains collected. First, the huge pension funds then the hedge funds got into this. The huge size of their investments influenced market behaviour.
They were not concerned about whether the actual businesses were doing well or not. On a dollar share, the dividend might be just 10 cents. But if the dollar share is pushed up to five dollars, the investment in one share at one dollar could yield four dollars in capital gains.
Then they invented short selling. The shares are not even necessary. They only go through the motion of selling and buying. Sell off the shares at the peak or thereabouts and then buy at lower prices to deliver to the buyers who had bought at the higher prices, collecting not just capital gains but also from delivery of the cheap shares they had acquired to the buyers who had bought at high prices when they began dumping.
But why stop at selling shares? Why not currencies and commodities? Sell non-existent currencies and commodities until the prices depreciate, then buy at the lowest price and deliver, collecting the difference between the buying and selling prices. The tin traders sold tin on the London Metal Exchange despite holding no tin stock themselves. When the time came for them to deliver, they could not. They should have been penalised. But the London metal exchange ruled that they need not deliver.
Currency trading alone can yield billions in profits. That in the process businesses, banks and countries go bankrupt is not of concern to currency traders. Through leveraging, they hold vast amounts of the currencies which can defeat any attempt by central banks of the affected countries to defend their currencies.
Then came the hedge funds. Through leveraging by 20 or 30 times, they could assure their investors huge returns. The hedge funds, their managers and the investors all made huge profits from their investments.
Greed knew no bounds. The banks began to lend money for housing and other assets even to borrowers who could not possibly repay their loans. If the borrowers failed to pay the loans, their properties could be seized and sold. They believed they could never lose on the loans made. To be doubly sure, the loans were bundled and sold to insurance companies or to mortgage companies such as Freddie Mac and Fannie May.
According to the lenders, their loans have been securitised through insurance and secondary mortgage. They just could not lose even if the loans became non-performing.
There were numerous other quick profit schemes, some so complex that the investors did not understand what would happen to the money invested by them. But they were assured that they would be making tonnes of money. And for a long time, they did get high returns on their investments.
All these products have one thing in common: they did not involve real money. No cash, no currency notes or bank

notes were involved - nothing; only figures in the books of banks. The amounts were enormous, running into trillions.

Capitalism has given many nations prosperity. But when capitalism is combined with unbridled greed; the result is what we are seeing today. First the market of the greedy demanded to be freed of government regulations or supervision. The market would regulate itself, but a market of greedy people cannot be expected to have ethics or even a sense of responsibility to themselves and even less to society. All the market cares for is to make money for the players regardless of what happens to other people or countries. They stretched the systems until they collapsed and precipitated the crisis.

These are the faults, the mistakes, the abuses which have caused the crisis in the Western financial system. The abuses are made possible because the system allows unlimited money to be created by the banking system. Loans by the banks have a guaranteed return. There was no risk for the banks. But new ways of guaranteeing returns were invented so that more money could be created and lent by the banks. The greedy played on the greed of people.

Now I would like to return to the subject of Islamic banking. It is not only about rejecting riba, usury or interest. Islamic banking is also about obeying the Islamic ethnical code in the market. In banking, there should be qard al-hassan - ie, good loans. Not only should it be usury free but there should not be hidden costs or gambling involved.

In Islam, making money from money is forbidden. So currency trading is not permitted. Gharar or risks, uncertainties and speculation are forbidden.

I am not suggesting that Islamic banking should replace the current banking system. But I would like to suggest there be more resort to Islamic banking systems and principles in order to prevent greed and abuses from taking over. Islamic banking should stay free from gambling and speculation, from the invention of financial products and unlimited freedom to create money and leveraging, which have all contributed to the downfall of the riba-based financial system.

In the absence of all these practices, Islamic banking would probably be slow in growing. But then, one must remember that the growth in wealth that we see in the countries which are based on the Western financial system is not real. It does not create jobs, nor increases in trade, nor spin-offs into other businesses, nor help to spread wealth equitably and profitably.

Islamic banking, without interest and subject to high moral codes, would or should not yield the aforesaid results. But because of these restrictions, the growth of Islamic banks in the future will be slow. The slow growth will also slow down economic growth and wealth creation, but the wealth created would be real, more fairly distributed, spin-off into real economic activities, creating jobs, increasing trade domestically and internationally.

There definitely is a future for Islamic finance. It would not be spectacular; it would not be the cause of booms and busts. It would be steady and would not cause the kind of social and economic upheavals that we are seeing today.

Islamic banking and the wealth of the Muslims will cause the rest of the world to link up with Muslim countries. Muslims will feel comfortable doing business without going against the injunctions of Islam. Provided that the abuses of the riba banks are avoided, there will not be the periodical collapse of the Islamic financial system. We are seeing how the Islamic banks have remained unaffected by the current crisis. Inshaallah, it will remain crisis-free in the future.

DETAILS

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